**DEPARTMENT OF STATE REVENUE**

**LETTER OF FINDINGS NUMBER: 98-0339**
**Gross Income Tax**
**For Tax Years 1993 through 1995**

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## ISSUES

### I. Gross Income Tax—Leased Equipment

**Authority:** First National Leasing and Financial Corp. v. Indiana Dept. of State Revenue, 598 N.E.2d 640 (Ind.Tax 1992); IC 6-2.1-2-2; IC 6-8.1-5-1; 45 IAC 1-1-28; 45 IAC 1-1-49

Taxpayer protests imposition of Gross Income Tax on leased equipment located in Indiana.

### II. Tax Administration—Negligence Penalty and Interest

**Authority:** IC 6-8.1-10-1; 45 IAC 15-11-2

Taxpayer protests imposition of a ten percent (10%) negligence penalty and interest.

## STATEMENT OF FACTS

Taxpayer leases equipment to Indiana customers. The Department of Revenue conducted an audit for the years in question, and issued assessments on income from the leased equipment. Taxpayer protests that it does not have an Indiana business situs and that the income has no connection to Indiana. Further facts will be supplied as necessary.

### I. Gross Income Tax—Leased Equipment

Taxpayer, an out-of-state corporation, leases equipment to Indiana customers. After an audit, the Department issued assessments for the years in question on the income from the rental of this equipment. Taxpayer protests that it did not pay Gross Income Tax on the income because it was following a decision by the Indiana Tax Court.

Taxpayer believes its situation is the same as in First National Leasing v. Indiana Dept. of Revenue. First National Leasing and Financial Corp. v. Indiana Dept. of State Revenue, 598 N.E.2d 640 (Ind.Tax 1992) In that case, First National Leasing leased train derailment equipment to a Hulcher Corporation, a wholly owned subsidiary. The equipment was used to place railroad cars and locomotives back on the tracks after a derailment. The lessee had a base in Indiana at which it stored some of the leased equipment. The Court decided that the taxpayer did not owe Indiana income tax on the income from the leases in that case because First National Leasing (taxpayer-lessor) had no control over the equipment. As the Court explained:

> The sole activity First National has in Indiana is ownership of equipment that is located in Bluffton independently of any direction, consent, or, often times, knowledge by First National. The critical transaction in this case is the leasing of property. First National executed its leases in Illinois and Texas, not in Indiana. The leases were not negotiated in Indiana; and the lease payments are not made or received in Indiana. Consequently, none of First National's activities related to the lease contract itself are conducted in Indiana.
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> First National Leasing, 644-5.

Regarding whether or not First National had a business situs in Indiana, the Court in First National Leasing explained:

> Consequently, although First National owns the equipment that Hulcher leases, locates, and uses in Indiana and elsewhere, the activities related to the lease formation and execution and the purpose of the lease, the use and possession of the equipment are overwhelmingly in quantity and quality activities conducted by Hulcher, not First National. The court therefore finds that First National's ownership of equipment located in Indiana is an activity that is not more than minimal, but is remote and incidental to the lease transaction from which its income is derived. Ownership alone is therefore not the degree of activity contemplated by the Indiana gross income tax statute.
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> First National Leasing, at 645.

In the instant case, taxpayer claims that its situation is exactly like that of First National Leasing. The leases are negotiated outside of Indiana, payments are made to a location outside of Indiana, and the equipment is located in Indiana. The Department determined through the audit that taxpayer's situation is different from that of First National Leasing since the equipment in question is not mobile and the leases require the customers to notify taxpayer when the equipment is moved. Taxpayer states that, even though its leases require the lessee to notify taxpayer when the equipment is moved, it does not conduct inventories and is not aware of such moves unless the lessee notifies it.

The equipment in First National Leasing, was mobile in nature, and was used in many states besides Indiana. Taxpayer claims that the equipment it leases is mobile, but in First National Leasing the equipment had to be mobile in order to travel to the scene of the derailment, whether in Indiana or any other state. The base in Indiana was little more than a parking lot for the equipment while waiting for the next derailment, at which point the equipment would be moved to any part of the country. After clearing the derailment, the equipment might be brought back to the Bluffton base or stored at another base outside of Indiana. The location of the equipment was determined at Hulcher's discretion and without notice or approval of First National.

First National's ownership of leased equipment located in Indiana was remote and incidental. Taxpayer in the instant case claims that the equipment can be moved without its approval, but has not established that its situation is exactly like that of First National, where the equipment was routinely moved out of Indiana for use without notification or approval of First National. Taxpayer submitted no documentation to support its position, despite repeated invitations to do so.

Taxpayer states that its rental income is not derived from sources within Indiana as described in IC 6-2.1-2-2(a)(2), which provides:

> (a) An income tax, known as the gross income tax, is imposed upon the receipt of:
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> …
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> (2) the taxable gross income derived from activities or businesses or any other sources within Indiana by a taxpayer who is not a resident or a domiciliary of Indiana.

The Department refers to 45 IAC 1-1-28, which states in relevant part:

> Rental income is any payment, in cash or other form, for the possession or use of real or tangible personal property for a limited period of time. The gross receipts, without any deductions, derived from the lease or rental of real or tangible personal property, whether actually or constructively received, are taxable at the higher rate under IC 6-2-1-3(g) *[Repealed by P.L.77-1981, SECTION 22.]*. The same rules apply to the gross receipts derived from subleasing.

Taxpayer states that the ownership of leased tangible personal property located in Indiana does not in and of itself create business situs in Indiana. In the audit report, the Department referred to 45 IAC 1-1-49, which states in part:

> For purposes of these regulations *[45 IAC 1-1]*, a taxpayer may establish a "business situs" in ways including but not limited to, the following

…

(6) Ownership, leasing, rental or other operation of income-producing property (real or personal)

Taxpayer leased income-producing property in Indiana, therefore taxpayer did have a business situs in Indiana, as provided by 45 IAC 1-1-49(6). Unlike the circumstances in First National Leasing, the equipment in this case did not end up in Indiana by coincidence. Taxpayer knew that it was leasing equipment to Indiana lessees. Unlike the train derailment equipment in First National Leasing, which had to be mobile to get to the point of the derailment, the equipment in this case is not mobile in nature. Taxpayer has not established that its situation is the same as in First National Leasing. The Department therefore finds that taxpayer's Indiana-based equipment also represents an Indiana tax situs for purposes of imposition of Indiana's Gross Income Tax.

## FINDING

Taxpayer's protest is denied.

## II. Tax Administration—Penalty and Interest

## DISCUSSION

Taxpayer protests the imposition of a ten percent (10%) negligence penalty and interest. Regarding the negligence penalty, the relevant regulation is 45 IAC 15-11-2(c), which states in part:

> The department shall waive the negligence penalty imposed under [IC 6-8.1-10-2.1] if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying our or failing to carry out a duty giving rise to the penalty imposed under this section.

In this case, taxpayer has demonstrated that it exercised ordinary business care and prudence in carrying out its duty to pay income tax. Therefore, taxpayer has affirmatively established reasonable cause, and the negligence penalty shall be waived. Regarding the interest imposed, IC 6-8.1-10-1(e) provides that the Department may not waive interest.

## FINDING

Taxpayer's protest is sustained in part. The negligence penalty will be waived. The Department is not permitted to waive interest.

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